RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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March 14, 1979 **LETTER 752** Mar. 2, DJIA 815.75; PTI 900; A-D Ratio –21.02
Mar. 9, DJIA 842.86; PTI 922; A-D Ratio –19.93

THE PICTURE: I've just finished reading a remarkable book entitled "Prince of the City" by Robert Daley (Houghton Mifflin) The book is the true story of the Special Investigative Unit of the NY Police Dept. It's one of the scariest, wildest, most unbelievable books I've ever read. The "plot" is real, the names are real, it all happened. The graft, the corruption, the ferocity, the cynicism in this book are almost more than the average mind can take in. It's a preview of Hades, but it's an education on life in the big city. I recommend it.

I've pondered the story in this book. The story is all based on one ongoing thread–nobody will be honest, nobody (with few exceptions) will turn down graft, almost nobody will stay with the truth. You want to know why the suicide rate on big city police forces is high–read *Prince of the City*!

And my thoughts go to our government. Many newer readers probably have the idea that I'm some kind of wild-eyed reformer–or perhaps I'm just a simple, hard-money kook, Or maybe Russell is just looking for someone (the Carter Administration) to blame all the world's troubles on. If that's what you think, forget it. Actually, I'm just an amateur mathemetician and confirmed moralist. I believe that 2 plus 2 equals 4 and I believe that telling the truth is EASIER than lying.

Look, I don't blame President Carter for the statistics above. It isn't Carter's fault that the Federal debt is now $793 billion and that the interest on that debt for the October through January period was over $20 billion (can you believe that!). No, what I blame Carter for is that he is not telling the American people what is going on. He's fantasizing, and he's lying by omission. Carter is not dealing with the hard facts. And the trouble is that the FACTS are now starting to explode over our heads. The luxury of pretending that there's no fiscal emergency has passed.

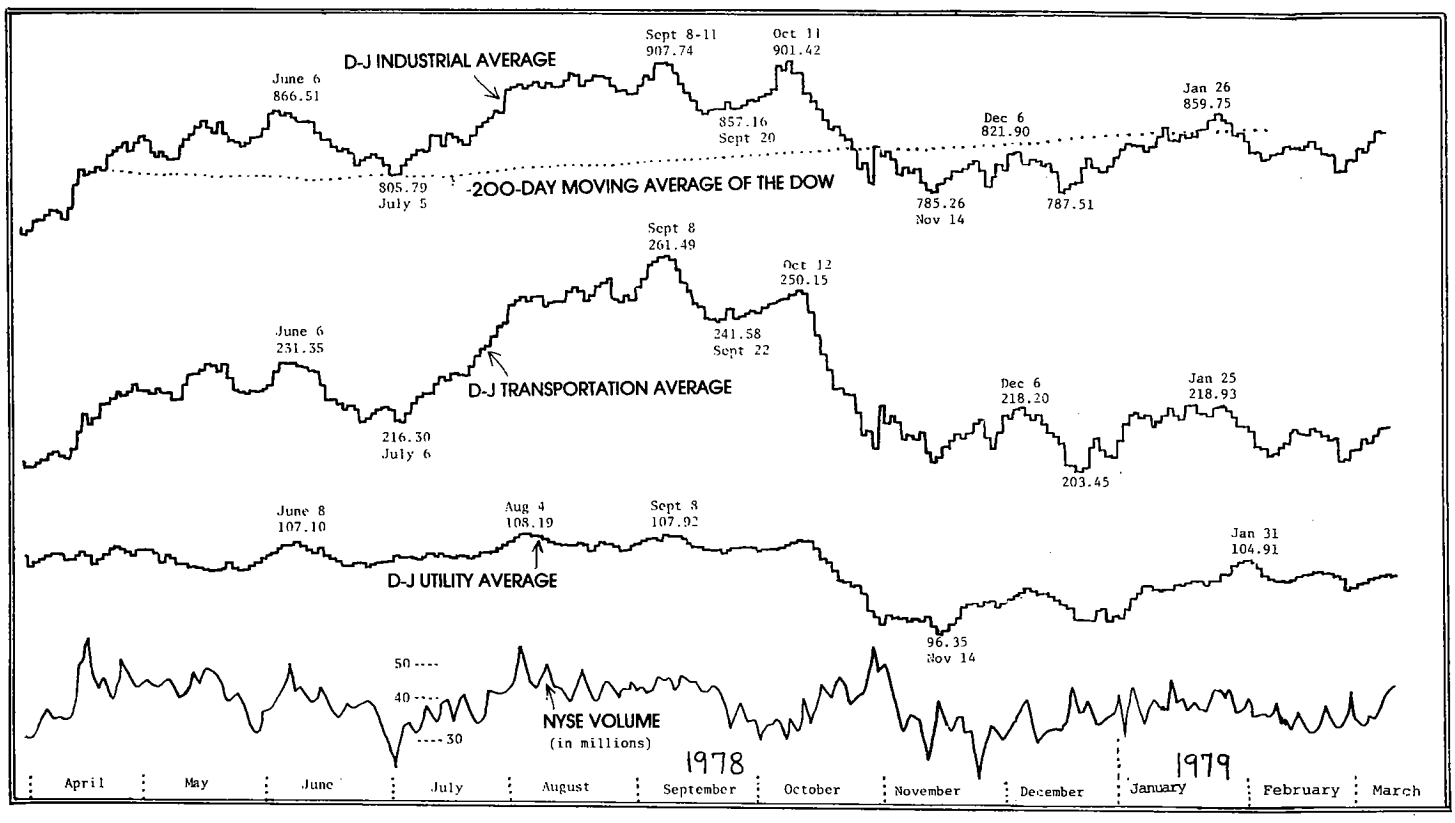
Government Finances

WASHINGTON (AP) — Here are the figures on government spending and debt (last six digits are omitted) as of March 2:

Total public debt	793,874
Interest on public debt for Jan.	4,412
Interest for fiscal year thru Jan.	20,277
Budget deficit for Jan.	2,731
Budget deficit for Jan. last year	3,717
Budget deficit fiscal year so far	26,499
Estimated deficit fiscal year 1979	37,379
Outlays fiscal year so far	164,313
Outlays same period year before	150,224
Gold for Dec.	11,671

The bitter, frightening fact is that the US Government is building national debt at the rate of about $3 to 4 billion a month. We're paying an additional 9% a year to service those increases in our national debt. This is the single, overriding fact in the US today (in my opinion). If we continue on this course (and I have every reason to believe we will) then this sytem, as we know it, will be in shambles some time during the 1980's. I know of no great nation that once, having tumbled from power, ever regained the heights again.

"Who needs the heights, Russell?" you retort, "Who has to be king of the world?" And my reply is, "It isn't a case of being king any longer. If the US dissolves into the world's biggest banana republic, then freedom will be so abridged in this country and the quality of life will be so changed, that many reading this Letter today will not recognize the "new nation." I have four kids that I'm bringing up, and I don't say that they have to be rich or even well off. But I want them to be free, to have freedom of choice. It's the choice that I see being taken away. A person who is bankrupt, a nation that is bankrupt, they just don't have many choices. And that bothers me more than anything else.



Here Comes the Recession

The outlook: modest slowdown, steeper prices, higher stock market

Recession will strike the U.S. economy later this year, but the slowdown will be shallow and brief.

Inflation will continue to oppress the nation, though prices will be rising at a somewhat lower rate at year's end than they are now.

Interest rates will continue to climb for several more months and then begin to decline rather substantially.

Economist Walter Heller of the University of Minnesota noted: "We seem to have an accident-prone inflation." For example, the extra-cold winter has dulled the sex drive of sows. Because they have not produced as many piglets as usual, the price of pork chops is going up. Though the economy is vulnerable to further shocks of climate, biology or politics, the members of TIME's bipartisan, multi-

up to 7% or 7.5%? Will the Administration have the guts to hang in with a moderate policy that provides some long-term hope that we will get inflation down?"

Signs of economic slowdown are beginning to appear. Indicators as disparate as factory operating rates and farm income slipped a bit in January. Most important, housing starts plunged 20% from

The "leading indicators" are down three months in a row. Housing starts are down. Chrysler and Ford closed down some plants for a few weeks to get "inventories in balance." And now Time Magazine makes it official–"Here Comes the Recession." Can the whole picture be that clear, that obvious? Can Time's ten-member Board of Economists be correct? My answer: maybe, but I wouldn't bet on it. What everybody knows, everybody is prepared for. What everybody is prepared for is usually well discounted, and therefore may not occur–at least for a while.

In this business you have to be flexible and you have to be a bit skeptical. To be flexible means that you cannot indulge in pride of opinion. The skepticism is necessary because you can't believe everything you read. Newspapers deal with news, and every veteran market man is brought up on the adage, "News known is news discounted."

I'm thinking more and more that we could get by most of 1979 without a recession. Or if we do have a recession, it's going to start in a very disguised form–more like a case of chronic and advanced "stagflation." To back up these thoughts I prefer to turn to the markets. And here are a few of the things I am watching.

Copper, a fairly good bellwether of economic things to come, has been making new contract highs. So far, this sensitive metal does not see a recession on the horizon. The CRB Commodity Index (see last Letter) is holding near its all-time high. That suggests continued inflation, and probably higher rates of inflation. The various interest rates are holding at or very near their highs. That indicates that money is still expensive–not "tight" mind you, just expensive. If a recession were around the corner, money rates would fall rapidly. That simply is not happening. Last but not least, the all-important November-December lows of 785.26 (Industrials) and 203.45 (Transports) on the D-J Averages have held despite a parade of the worst international news in recent history. That tells me that the market doesn't see the big trouble–yet.

In Letters late last year and in January I said that I expected 1979 to be a very tricky year–an "expensive year" for speculators and traders. The markets and the economy are now analyzed, re-analyzed, picked over, researched, scrutinized to an extent that I have never seen in my 25 years of experience. The result of this "over-analysis" is going to be frustration and impatience. "Why don't these markets do something?" I'm asked. To which I answer, "They are doing something–they're driving investors and traders out of their skulls!"

Against all this over-analysis I opted for liquidity and the comfort and safety of some of the greatest bargain yields in US history. One-year Treasury notes at 9.5% yield, 91-day T-bills at 9.4% yield; anyone who is truly interested in bargains would have to be interested in this kind of merchandise. But there are a lot of people who couldn't care less about investing and prudent handling of assets. These people are crowding Reno and Vegas and Atlantic City. And thousands more of them are standing in the back of the local boardrooms.

In 1934 the great Dow Theorist Robert Rhea, wrote a book entitled "The Dow Theory Applied To Business and Banking." In the book Rhea showed how the forecasting abilities of the Averages could be used to great advantage, not only for investors, but for businessmen and bankers as well. When events become confusing and complex (as they now are), I always fall back on the classic Dow Theory principles. These market principles have lasted for over half a century, and they are as valid today as when they were first formulated (in modern form) by William Hamilton during the 1920's.

Turning to the page 1 chart of the Averages, everything I said in the last Letter regarding the market situation still stands. The last important peaks in the Averages were recorded in late January, Industrials at 859.75 and Transports at 218.93. The Averages have not been higher since. But a bettering of BOTH of those points would certainly be a forecast of higher prices on Wall Street and better times in the economy. From a Dow Theory standpoint, there's no question about that.

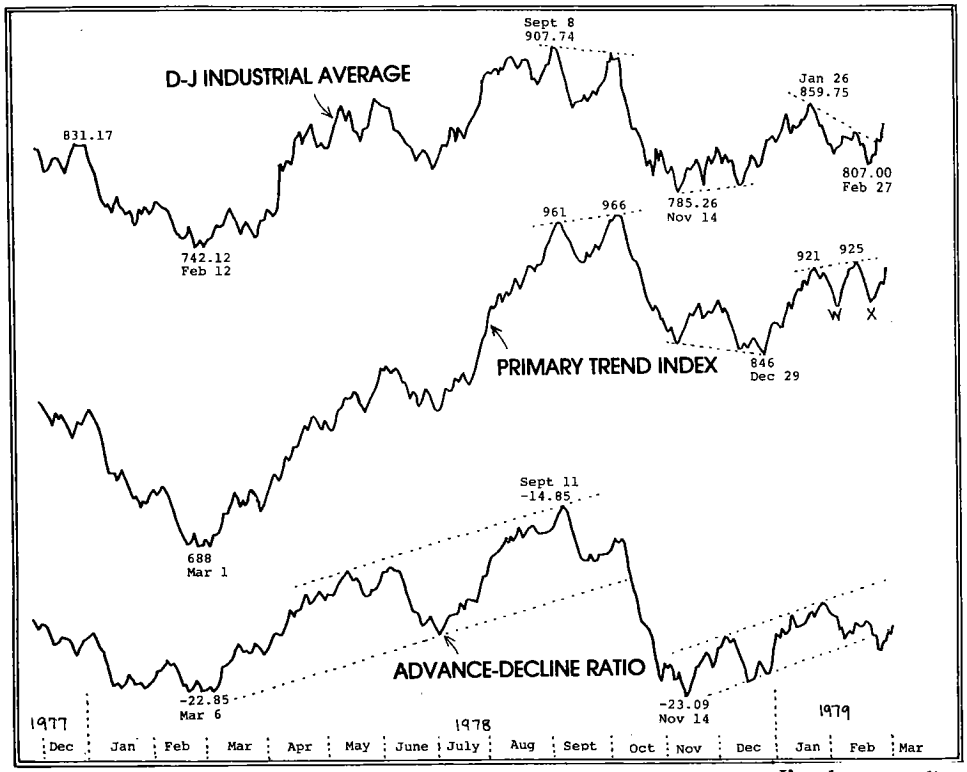
The last significant low was recorded on November 26 for Industrials, at 785.26. The corresponding low for Transports was recorded on December 30 at 203.85. If the Averages turn down and BOTH break those lows, then as far as Dow's Theory is concerned, we have a classic bearish signal (re-confirmation of the primary bear trend) as well as a forecast for lower stock prices and an economic recession (or depression).

That kind of reading would have sufficed for Robert Rhea, who was, to my mind, the greatest interpreter of the Averages in stock market history. But hope (and probably ego) never die, and I have attempted to bring still other indicators to the cause of market analysis. Two of the indices which I watch most closely are the Primary Trend Index (PTI) and the Advance-Decline Ratio for the NYSE.

The page 3 chart shows the Dow and these two indices (daily basis) from December, 1977 to the present. Since September, 1978, the Dow and the PTI (the latter being an amalgam of 8 important averages and indices) have traced out a most unusual series of divergences. Note that the Dow hit 907.74 on September 8 with the PTI at 961. A few weeks later the PTI rose to 966, but the Dow would not confirm, This led to the so-called "October massacre."

On December 29 the PTI recorded a new low of 846, but the Dow refused to confirm this low. The aftermath was a rally to Dow 859.75 (January 26). The PTI pushed up to a peak of 925, but here the Dow again refused to confirm, and a decline took the Dow back to 807.00 (February 27), a low for the year. From here, the larger picture is clear enough. Bullish action would require the Dow to better first 859.75, then 907.74. This should be confirmed by a bettering of first 925 on the PTI, then 966. On the downside, the critical points are 785.26 for the Dow and 846 for the PTI.

At the bottom of the chart we see the A-D ratio, which acts very much like an unweighted average for the NYSE. After the September-October non-confirmation, the A-D dropped an



astounding 8.24 points in a period of two months, probably the worst breadth collapse in NYSE history. The cave-in literally wiped out all the gains of the year and took the A-D ratio back to its level of December, 1976.

I have drawn channel lines for the A-D ratio, and it is interesting to note how all the action since early-1978 has taken place within the confines of the two rising channels. During September, 1978 the A-D plunged below the lower limit of the first channel. Bottoming on November 14, the second channel then began forming. By late-January, 1979, the A-D had recovered slightly less than half its 1978 losses. But on February 27 the market turned extremely weak, and that day saw the A-D ratio plunge below the lower limits of the second channel. That leaves the minus 23.09 mark as the important level for the A-D ratio. The ability (or inability) of the A-D to hold above last November's low will tell us a lot about this market during the weeks ahead.

One point is worth making: The A-D ratio has been *relatively weak* ever since its November 14 low. This suggests that any good Dow rally from here would probably NOT be confirmed by the A-D ratio. For instance, the Dow could climb above 859.75 and even 907.74 but it would take a tremendous upside effort by the A-D to confirm. Such disparities between the Dow and breadth often forecast impending trouble in the market. And of course, the shocking A-D collapse of September to November (now all but forgotten) would have marked the beginning of that trouble.

NOTES & QUOTES: US citizens still have the only "bargain gasoline prices" in the world (outside the OPEC nations). We pay 70–80 cents for premium gas in California. Here are some other prices: Israel and S.Africa $2.50, $1.27 in Australia, $2.05 in Japan, $2.62 in Portugal, $2.50 in France, $2.10 in Austria, $1.39 in Britain, $2.27 in India. How much longer will gas be under $1 in the US? My guess, another six months or so. One cute San Diego trick–many San Diegans go across the Mexico border and fill up on diesel fuel at 23-cents a gallon! Mexico's diesel is a bargain although premium gas runs about 68-cents.

* *

On March 8 the Fed decided to turn the credit screws a little tighter. They therefore removed the advantage of the "six-month" certificate that has brought in $104 billion to the savings & loan industry. The special S&L certificates have paid the going 6-month T-bill rate PLUS ¼% PLUS compounding the money. The fed said, no more ¼% (at rates over 9%) and no more compounding.

The S&L's are now competing directly with the banks, but more importantly they are now competing directly with the Treasury for more money. And the Treasury enjoys the advantage. Why? Because interest on Treasury obligations is exempt from state taxes. So I would expect some intermediation to occur in the weeks ahead, which means that the S&L's are going to lose deposit money. Result: less money for housing at a time when money demands are running heavy. All of which brings us closer to something I've long predicted–when the chips are down the Government will take on all comers for money–and they'll win!

* *

I've always held that a government will do anything, and I mean ANYTHING, to perpetuate itself. Against a national emergency, no single act of the citizen can insure his freedom or even his life. The right to hold gold, guns and read a free press are barometers of a free society. A dictatorship will outlaw those rights immediately. Why? A free press tells you what they're doing to you, guns allow you to protect yourself, and gold allows you to "get out."

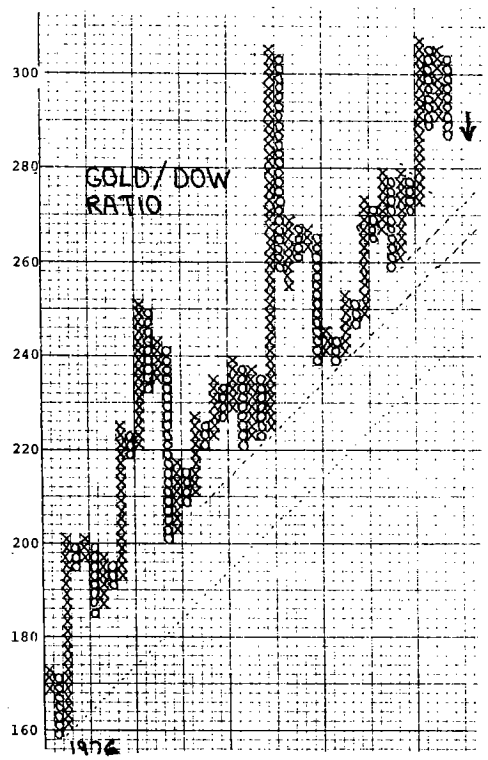
Along these lines, I thought the following (from Fiat Money Inflation in France, by A. D.White) was rather informative: *"Involved in all these perplexities, the Convention tried to cut the Gordian Knot. It decreed that any person selling gold or silver coin, or making any difference in any transaction between paper and specie, should be imprisoned in irons for six years–that any one who refused to accept a payment in assignats or accepted assignats at a discount, should pay a fine of 3,000 francs. A second offender should pay a fine of 6,000 francs and suffer imprisonment twenty years in irons. Late, on Sept. 8, 1793, the penalty for such offenses was made death, and a reward was offered to any person informing the authorities regarding such criminal transactions.*

"To reach the climax of ferocity, the Convention decreed (May 4, 1794) that the death penalty should be inflicted on any person convicted of having asked, before a bargain was concluded, in what money payment was to be made. Nor was this all. The great finance minister, Cambon, soon saw that the worst enemies of his policy were gold and silver. Therefore it was, under his lead, that the Convention closed the Exchange and finally (Nov. 13, 1793) under terrifying penalties, suppressed all commerce in precious metals.

But of course, those were barbarous times, inflation was horrendous, and any repeat of this kind of thing could never happen again.

* *

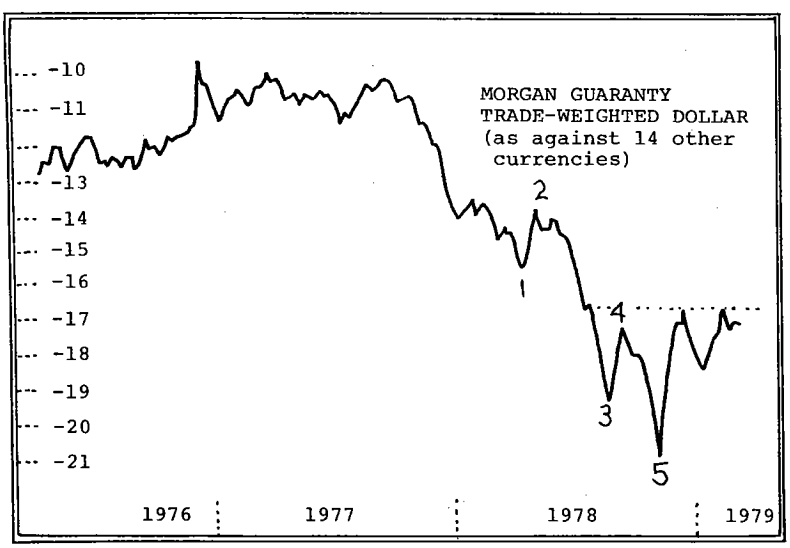
This is a P&F chart of the ratio of gold to the D-J Industrial Average (figured daily). In other words, this is the ratio of gold divided by the Dow. When the ratio goes up it means that gold's relative strength is improving in terms of the Dow. When the ratio declines the Dow is showing superior relative strength to gold.



As you can see, on a trendline basis gold has shown better RS than the Dow ever since 1976. But the ratio now shows a double top in the 306-308 area, and last week this chart gave a trend signal in favor of the Dow against gold. Thus, we can expect the Dow to outperform gold for a while The ability of the ratio to hold above the rising trendlines will be crucial in the period ahead.

* *

Poised on "the edge" is my weekly chart of the Morgan Guarantee "trade weighted dollar." This is the dollar measured against 14 other currencies (the currencies weighted for volume of trade). Following the crushing downward smash (a smash that was divided into 5 distinct waves down), the trade-weighted dollar has now formed a base and a potential "head-and-shoulders" bottom. If this chart can break out into the minus 16 area, the dollar will be showing remarkable strength, and in that case I would expect a 50% retracement of the entire 1977-78 collapse.



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It ain't easy. Last April the Stock and Bond Club and the Stockbrokers Society (both of San Diego) picked 10 stocks ($10,000 of each) to outperform the market over the next year. With a month to go, the two $100,000 accounts look like this: the Stock and Bond Club's list is worth $92,000. The Stockbrokers list is worth $86,000. It's been a hard year all around.

Carter Denounces Move To Bar Budget Deficits

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON – President Carter again bluntly assailed the idea of a constitutional convention to draft an amendment requiring a balanced federal budget.

"The constitutional convention process would be the worst imaginable route" to a balanced budget, Mr. Carter asserted at his news conference yesterday. He said such a convention might result in "unlimited" constitutional "which would change the ... and the

* *

When the chips are down and all is said and done, the politicians are scared to death of any law which forbids budget deficits. Here's President Carter, who talked about no deficit in '81 now being backed against the wall. Attack is the best defense. So what does Carter say? Well read it if you have the stomach.

The one thing politicians are afraid of is that the people might take away their ability to spend, spend and spend some more. If the markets (rather than the law) takes away that ability to spend, the US is going to find itself sitting in the midst of a disaster.

* *

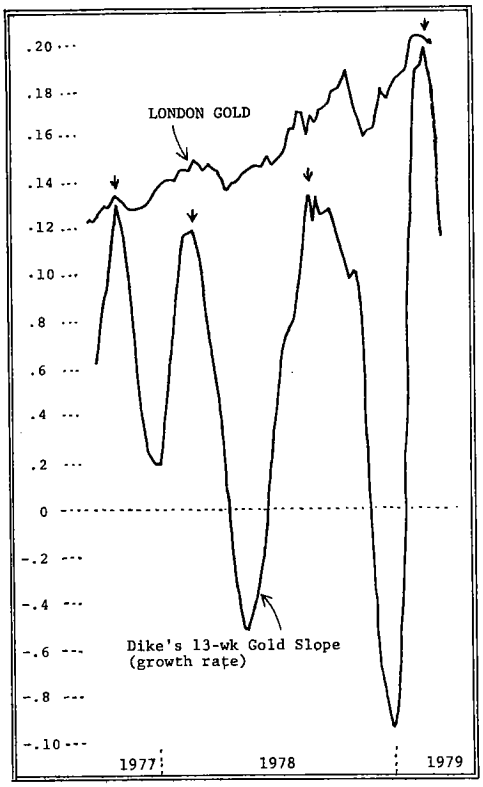
The European Monetary System (EMS) could go into effect next week. This would mean that the dollar would have another competitor in the form of major European currencies floating within the new snake. Although the new system will take some of the strain off the dollar, it cannot be forgotten that the EMS was developed as a protection against the dollar's weakness. I wonder if (in time) the US may not have an internal and an external dollar. The external dollar would be gold backed, the internal dollar would be a piece of paper. US Citizens would be forbidden to own the external dollar.

GOLD: In 1970 with gold at $35 an ounce you could buy a double eagle (one ounce of gold) at $40 to $50. In 1971 you might have paid $70 for the same coin. Five years later, in late-1976 you could have purchased an ounce of gold for under $100 a coin. All were obviously good buys. Now, with gold at $240 to $250 an ounce, and with short-term interest rates near 10%, it COSTS you $25 per year in interest to carry an ounce of gold. As I see it, gold is no longer a bargain. But it is insurance against disaster and insurance against a sudden collapse of the dollar.

Nevertheless, 240-250 gold presents a problem to the investor. Gold is now about where it was back in October. The holder of gold since October has given up a potential 10% return on his money for almost half a year. As interest rates rise from here (and there is a fair chance that they will) the cost of holding gold will be even higher. This is the reason why the prudent investor will only hold gold as a percentage of his portfolio, 8%, 10%, 15% but only as a limited percentage of total assets.

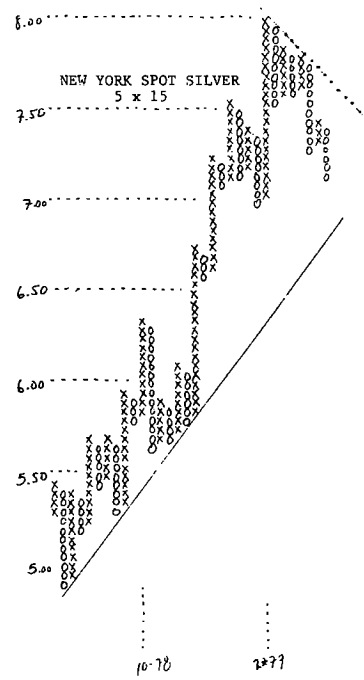
I am including here (page 5) a chart which I have constructed from weekly figures provided by my friend, Sheldon Dike (S. H. Dike & Co., 1420 Carlisle Blvd. N.E., Albuquerque, NM 87110). This chart shows the weekly price of gold superimposed upon a line which measures the slope of a straight line connecting the current price of gold with the price 13 weeks ago. A rising

slope line on ratio scale indicates rising momentum (or growth rate) for gold, and a declining line indicates a declining growth rate.

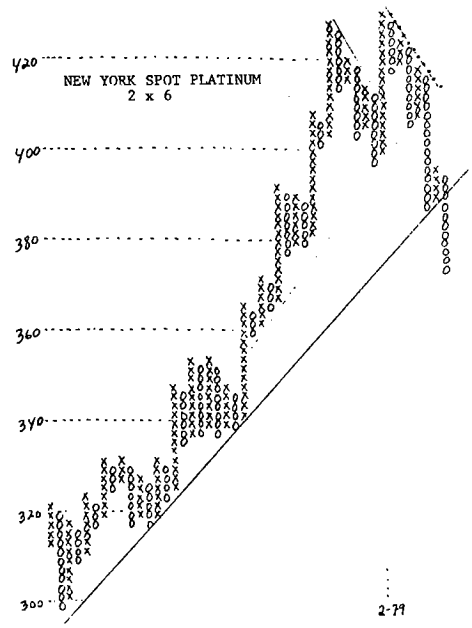


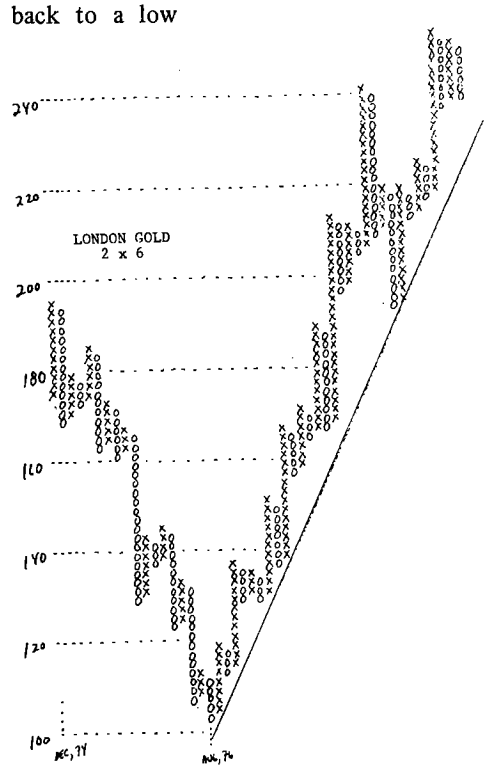
Two weeks ago Dike's slope line turned down from a very high level. The chart shows three preceding downturns in the slope line, and the average decline of these three downturns took 11 weeks to complete. There is obviously no way of predicting how long the current downturn will take, but it should carry for at least 6 to 10 weeks and take the slope line near or below zero. The ability (or inability) of gold to hold near recent highs as this "growth correction" unwinds should tell us a lot about the inherent power of gold during 1979. At the termination of this correction, I will probably advise new positions in gold or a build-up in positions which have been reduced.

That leaves us with gold, and I am growing increasingly suspicious of gold's ability to hold up, with the other two metals looking this toppy. At a spot price of 237, gold would give us a bearish signal. At around 232-234 gold would break its rising trendline (on a P&F chart), a trendline that has held since the 1976 bottom.



All of which takes us to my chart (page 6) of bullion (plotted daily) along with the gold stock averages (GSA). As readers know, the valid moves occur when these two items confirm each other, each through preceding important points. Note the collapse of GSA in October, even as gold was pushing up to its 243 peak. The resultant smash took gold back to a low of 193.

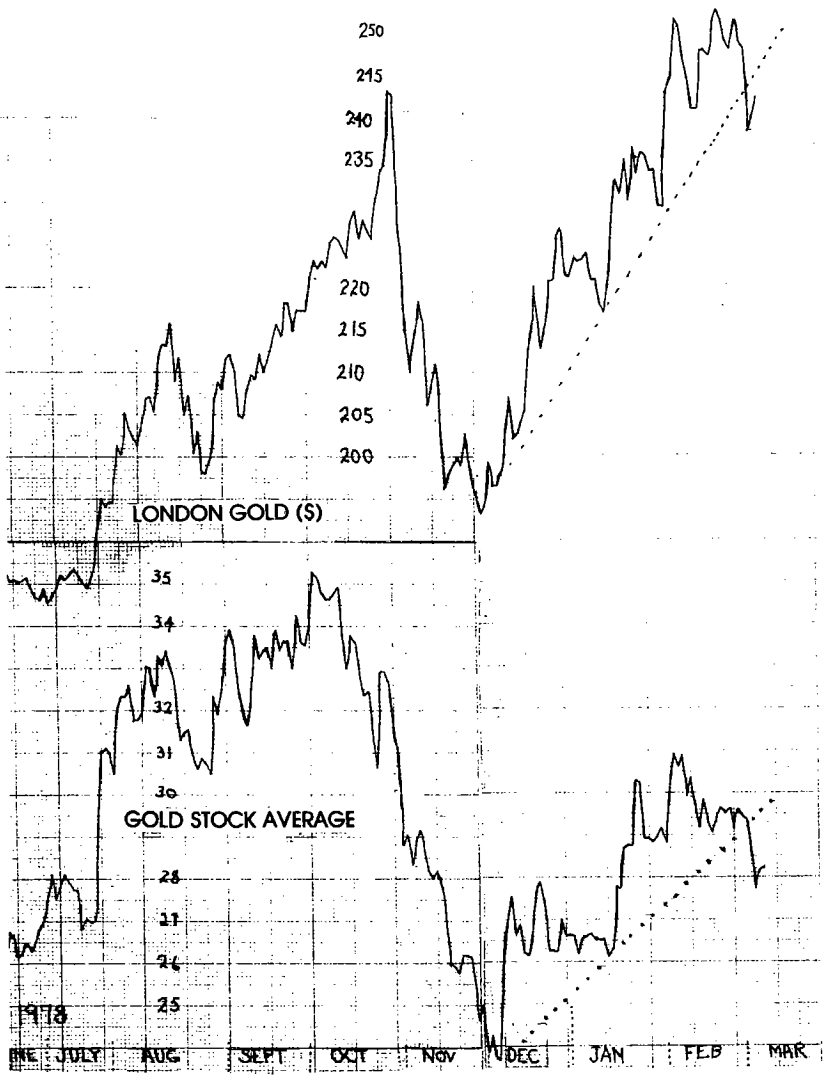


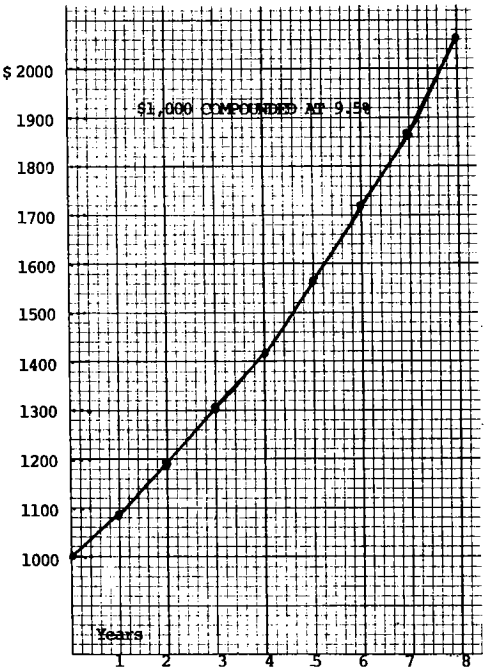


The three precious metals are gold, silver, and platinum. As a rule, the three precious metals tend to move together. Sometimes one leads, sometimes another.Jon Strebler commodity ace with Bache here in La Jolla, made these three P&F charts up for me, and I think they are instructive. The first chart shows platinum topping out and smashing through its intermediate trendline. There's no guessing here: platinum has "had it" for a while, and the best I see for the metal is a pullback under the broken trendline.

Silver (which has given traders a big run for their money) did what I suggested it "might do" in the last Letter. It dropped sharply, but I would want to see spot silver at around 6.80 to 6.90 before I would say that it's through. Nevertheless, silver looks "heavy" on the charts, and I would lighten up here.

But on the new rise GSA was most reticent about confirming. In early February the GSA topped out, having recovered slightly better than half the losses of October to December. From there on (as was the case last October) bullion was on its own. Last week both bullion and GSA broke their most recent trendlines. My feeling here is that gold should test the halfway level of the rise from 193 to 254, and that level is about 223. If gold can consolidate and hold above the 223-225 level, all will be well, and it will be worth reaccumulating. But if the 223-25 level is broken, gold will probably come down to test the 200 level again. But let's worry about that if and when it happens.





now borrowing at rates above 9%. These borrowed billions will rise like a spector during the 1980's. They will represent one of the greatest menaces in US history. And all the markets, all of them, know it. Consciously or unconsciously, they know it!

Conclusion: *Liquidity* is the stance at this time. Let's allow interest rates to work for us, rather than letting them break us. If you remember nothing else in these Letters, remember that. It's not what you own that breaks you, it's what you owe!

NEXT MAILING: March 28th

LATE NOTES: There's a "sickness" hanging over the markets. Aside from the dismal foreign news and the incompetence of the Carter Administration, there is "something wrong" and no one seems to be able to put his finger on it. The sickness takes the form of fits and starts in all the price movements, and I don't care whether you're talking about stocks, bonds, commodities or gold. Price will run up for a day or two, and just as it appears that a real rally has started, bloop, the price movement goes dead and then sinks back again.

My own thinking about the problem centers on the accompanying chart. This chart shows what happens to $1,000 compounded at the rate of 9½%, which (surprise) is about the rate of return on a US Treasury bill. What we see here is money compounding rapidly, so rapidly that in a matter of 8 years the $1,000 has doubled. Now a safe way to double your money in 8 years constitutes tough competition, very tough competition for ALL OTHER forms of investments. You talk to a wealthy investor, an investor in stocks, real estate, shopping centers, you name it. You tell him that such and such is a great speculation, and that you're even buying it yourself. And no matter what you say, in the back of this millionaire's mind is that nagging voice that says, "Who needs it, I can double my money with no sweat in 8 years!"

That concept, I believe, is what's bringing on the sick markets of the 1970's. It is also well to realize that borrowers are subject to the same laws of compound interest. For instance, the US is

Courtesy Playboy